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STATE FOR EAP/CM AND EEB/OMA, TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD HK CH
SUBJECT: SKITTISH DEPOSITORS LINE UP OUTSIDE BANK OF EAST ASIA BRANCHES

REF: A. HONG KONG 1737; B. HONG KONG 1762

¶1. Summary: A rumor from undetermined sources spread throughout Hong Kong on September 24 that two local retail banks have "excessive exposures" to Lehman Brothers-backed structured finance products. The rumor, which named only the Bank of East Asia (BEA), resulted in hundreds of local depositors lining up to withdraw their funds from BEA throughout the afternoon at BEA branches across the city. These latest difficulties for BEA followed the bank's disclosure on September 18 that its earnings required restatement, due to "unauthorized manipulation" of its credit derivatives portfolio (ref A). Senior HKG and BEA officials strongly denounced the rumors, and declared the bank's asset base and liquidity position fundamentally sound. Hong Kong Monetary Authority (HKMA) Chief Executive Joseph Yam promised his organization's "full support" for BEA. Meanwhile, Nomura International stated it will not assume the liabilities related to structured finance products arranged or sold by Lehman Brothers entities in Hong Kong; these include the highly controversial Lehman-arranged "minibonds" to be liquidated as part of Lehman's bankruptcy (ref B). Disgruntled investor representatives met with HKMA officials and delivered formal complaints lodged by 660 individual minibond investors. End summary.

Background on BEA, Local Deposit Insurance Program

¶2. As of June 30, 2008, BEA had total assets of USD 51 billion (HKD 397 billion), with capital levels in excess of international standards. BEA's self-described exposure to Lehman Brothers and AIG totals USD 54 million (HKD 423 million) and USD 6.4 million (HKD 50 million), respectively. If BEA's statements are true, loss reserves related to those exposure amounts would be material -- but not dangerous -- for the bank to absorb. In addition, Hong Kong's depository institutions such as BEA remain somewhat shielded from customer panic by Hong Kong's deposit insurance program administered by the HKG. Similar in form and purpose to the Federal Deposit Insurance Corporation (FDIC) in the United States, Hong Kong's retail bank insurance program protects an individual's deposits, albeit up to only USD 12.8 thousand (HKD 100 thousand). The program was established after the Asian financial crisis of 1997-98. Since inception, it has not been obligated to reimburse any depositors of a failed institution.

Chronology of a Mini-Run

¶3. BEA branches on Hong Kong Island and in Kowloon faced an increasing volume of depositor withdrawals on September 24, as rumors intensified about the bank's financial health. Lines soon formed on the streets outside the branches, despite a heavy local rainstorm. Local staff of the Consulate General confirmed that the police showed up at several BEA branches to ensure maintenance of order, although the queued depositors appeared unagitated.

¶4. In response to local depositors' reactions to the market rumors, the HKMA issued a statement in the early afternoon. The HKMA said, "The rumors about Bank of East Asia's financial situation are groundless. The Hong Kong banking system is safe, healthy and in good operating condition. The local banks have sufficient capital and liquidity, and the quality of their assets is good." The office of the Financial Secretary also issued a statement at 1500 HRS local time, stating that the Hong Kong banking system "is stable and healthy, with sufficient capital." The statement also described the BEA rumors as "groundless."

¶5. At 1530 HRS local time, Joseph Pang, Bank of East Asia's Deputy Chief Executive, held a press conference and reassured the public that BEA had "no troubles." He said BEA would allow customers to withdraw their time deposits in advance of maturity, if they desired. Pang said all branches of Bank of East Asia extended their working hours by half an hour on September 24, in order to "meet the demands of customers."

¶6. In the HKG's latest response to the situation, HKMA Chief Executive Joseph Yam held a press conference at 1630 HRS local time. Yam told reporters that BEA has no liquidity problem and has only "limited" exposure to Lehman and AIG. He said the rumors "would sabotage confidence," and he called upon the people of Hong Kong to remain calm. He said, "The equity ratio of BEA is over 14 percent, compared with the minimum requirement of 8 percent. BEA's liquidity ratio is about 40 percent, greatly surpassing the minimum requirement of 25 percent. Both BEA's asset quality and operation are fine." Yam said he the HKMA would fully support BEA, including provision of liquidity to the bank, if necessary.

Nomura Rejects Support for Lehman-Issued "Minibonds"
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¶7. As purchaser of various Lehman Brothers assets and operations in Hong Kong, Nomura International told Apple Daily newspaper on September 24 that it will not assume Lehman's liabilities on structured finance products sold or arranged by Lehman in Hong Kong. Nomura explicitly mentioned it will assume no obligations related to the approximately USD 1.6 billion of Lehman-arranged "minibonds" sold to retail investors here.

Minibond Complaints Delivered to HKMA

¶8. A newly-elected Legco member from the Democratic Party (DP), Kam Nai-wai, joined 50 Lehman minibond holders in a September 23 meeting with HKMA officials. The disgruntled investors handed over documents detailing 660 complaint cases involving HKD 686 million of Lehman-arranged minibonds. A spokesman for Hong Kong's financial secretary told Apple Daily that the HKG was still reviewing the applicable regulatory mechanisms governing the packaging and sale of the minibonds. The spokesman cautioned that this review process "would not help the minibond investors for the time being." These latest steps followed a DP-organized gathering on September 22 of 800 irate investors in Lehman-arranged minibonds.

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